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IN THE

Supreme Court of the United States

OCTOBER TERM, 1932.

No. 182

PINELLAS ICE & COLD STORAGE COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

REPLY BRIEF FOR PETITIONER.

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INDEX.

	Page
Reorganization	3
Continuity of interest	6
Stock or securities	9
Plan of reorganization	9
Party to reorganization	10
The amount paid to creditors	11

AUTHORITIES CITED.

Green v. Commissioner, 24 B. T. A. 719	7
Revenue Act of 1926, Sec. 2(b)	11
Revenue Act of 1926, Sec. 203(e)(1)	1
Revenue Act of 1926, Sec. 203(h)(1)	3
G. C. M. 1753, VI-1 C. B., p. 138	7
G. C. M. 8565, IX-2 C. B., p. 127	7

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REPLY BRIEF FOR PETITIONER.

With great respect, we believe that counsel for Respondent has entirely misunderstood both the meaning and the purpose of Subdivision (e) (1) of Section 203 of the Revenue Act of 1926. The theory of Respondent throughout his brief is that it was the purpose of Congress to "defer" or "postpone" the imposition of a tax on a corporation in cases where the transaction in question was

only a change of form and not of substance. On the assumed "theory" it is then urged that during the "deferment" or "postponement" of tax on the corporation there must be a "continuity of interest" in the transferee corporation. This theory would have a degree of plausibility if the case before the Court were under the statutes as they existed prior to the enactment of the Revenue Act of 1924, or even if the case were under other provisions than Section 203 (e) (1) of the Revenue Acts of 1924 or 1926, which provision is the same in both Acts.

The expressed purpose of Congress was not to *postpone* or to *defer* a tax on the corporation, but to impose one tax and only one tax, and that on the stockholder, where the transaction constituted a transfer of all of the assets of a corporation, a liquidation of the corporation, and distribution of the proceeds to the stockholders. The purpose of Congress was to relieve what was an admittedly unjust and burdensome double taxation. The relief was to be permanent, not a mere postponement. It was pointed out by the Treasury Department, and the Committees of Congress that where the stockholders sold the stock of their corporation to another corporation and the purchaser liquidated the assets of the original corporation, there would be but one tax and that upon the stockholders. The avowed purpose of Congress was that where the same result was accomplished in another manner, there should be the same tax result, that is, one tax and that on the stockholders. (Report of Finance Committee of the Senate; Report of Ways and Means Committee of the House; Statement (by Treasury Department) of Changes made in the Revenue Act of 1921; Petitioner's Brief, page 13 *et seq.*, 20, and 31.)

It is clear that the theory of Respondent's brief is that the purpose of the statute was to defer or postpone recognition of gain or loss and that a continuity of interest should exist during such deferment. The opening sentence of the

summary of argument, page 4 of Respondent's Brief, is as follows:

> "The purpose of the statute was to defer the recognition of gain or loss in any case where an exchange resulted merely in a change of form and not of substance, and all of its provisions should be interpreted to effectuate this underlying purpose."

See similar statements on Pages 9, 11, 12, 15, etc.

The contention that there must be continuity of interest loses its applicability unless the taxable gain or deductible loss is merely deferred until a final disposition of the stock or securities received. The idea is wholly inapplicable to a case where the corporation is liquidated and dissolved and the resulting tax is solely a problem for the stockholders under other provisions of the statute. The double taxation which existed prior to the Revenue Act of 1924 was removed by eliminating the tax on the corporation. In such cases the change is one of substance, not of form, and there need be no continuity of interest where the liquidating corporation is a mere conduit to transfer to its own stockholders the proceeds received from the acquiring corporation. Congress said the result should be the same as if the stockholders had sold their stock and the purchasing corporation had liquidated the transferor corporation; that is, one tax instead of two and that one on the stockholders.

Reorganization.

At the outset, we think it essential to determine whether or not there was a "reorganization" within the meaning of section 203 of the Revenue Act of 1926. Section 203(h)(1) defines a "reorganization"' as being, among other things, "the acquisition by one corporation of * * * substantially all the properties of another corporation." It is petitioner's contention that this definition means exactly what

it says; that the acquisition by one corporation of substantially all of the assets of another corporation of itself constitutes a statutory reorganization. In Petitioner's Brief, pages 15-28, we pointed out that this has been the interpretation by the Treasury Department and by the Board of Tax Appeals. We are somewhat at a loss to understand whether Respondent now proposes that such interpretation should be changed. In his brief, page 16, Respondent says:

> "We are informed that the consistent administrative construction of section 203 (h)(1)(A) by the Treasury Department has always been that the acquisition of substantially all the property of a corporation (even though not amounting to a merger or consolidation) is a 'reorganization' within the statute, provided the transaction meets the other statutory requirements."

It will be noted that counsel added the words "provided the transaction meets the other statutory requirements." It is respectfully submitted that the statutory definition of a "reorganization" is complete in itself and defines a reorganization regardless of the tax result. The definitions of "reorganization" by the Treasury Department and by the Board of Tax Appeals were not limited with any provisos, and counsel now point out that the interpretation by the Treasury Department is probably the correct one and that the Circuit Court of Appeals for the Fifth Circuit, if it held otherwise, was probably incorrect. We do not think that from a reading of the opinion of the Court below there can be any doubt that it did predicate its decision upon an interpretation of the definition of a "reorganization" different from that now contended for by both petitioner and respondent.

There being a reorganization, we then look to other provisions of the statute for the ensuing tax result. Whether

or not there is a taxable profit or deductible loss and upon or by whom, must be determined from other provisions of the statute. Counsel for respondent is contending that whether or not there is a "reorganization" within the statute depends upon how the acquisition of all of the assets of another corporation took place. We have pointed out (Petitioner's Brief, page 30, *et seq.*) that it makes no difference how the assets of the transferor corporation were acquired by the transferee. The name for the transaction is of no importance. Whether the instrument transferring the assets be called "exchange," "sale," "conveyance" or any other word describing the transfer of the assets from one person to another is wholly immaterial. It was in support of this statement that we cited the language of the Treasury Department in its proposals to Congress, the language of the Finance Committee of the Senate, of the Ways and Means Committee of the House, and of the Regulations of the Treasury Department in interpreting the statute showing that the words "sale" and "exchange" were used interchangeably in listing and defining the kind of transactions which constituted a statutory reorganization.

We consider it of no importance whether the particular transaction in this case be called a "sale" or not. It was undoubtedly an exchange. (Petitioner's Brief, pages 30-35) The "exchange" or "sale" or whatever it may be called in this case, however, was not a transfer of property solely for cash but was in fact a transfer in consideration for $400,000.00 paid in part directly to petitioner's creditors and in part to petitioner for the expressed purpose of paying its creditors, and $1,000,000 in promissory notes *secured* by first mortgage bonds not only on the property owned by petitioner but on all the property of the Florida West Coast Ice Company, the transferee. The argument suggested by counsel for respondent with reference to a transfer solely for cash is inapplicable to the case at bar.

Having a statutory reorganization by the transfer of substantially all of the assets of one corporation to another, we then look to other provisions of the section to ascertain the taxable effect of the transaction. If property held for productive use in trade or business is transferred for like property, there is no tax under (b)(1). If stock or securities are exchanged for stock or securities in such corporation or another corporation a party to a reorganization, there is no tax under (b)(2). If property of a corporation is transferred solely for stock or securities to another corporation a party to a reorganization, there is no tax under (b)(3). If the transferor corporation receives in addition to non-taxable proceeds, money or other property, and keeps them, the gain is subject to tax, but not to exceed the money or other property received (subdivision (d)(1)). If, on the other hand, there is a distribution to the stockholders, there is no tax on the corporation (subdivision (e)(1)) and that is the case at bar. If the transferor corporation receives money or other property with the stock or securities, it may not take a loss (subdivision (f)).

CONTINUITY OF INTEREST.

The necessity of continuity of interest in order to constitute a reorganization does not exist in the statute except where it is specifically so provided. The statutory definition of reorganization was first adopted in the Revenue Act of 1921. Senator Simmons, then Chairman of the Finance Committee of the Senate, in discussing the following language:

> "a majority of the voting and at least a majority of the total number of shares of all other classes of stock of another corporation, or of substantially all of the stock of another corporation * * *"

said:

> "That is in the disjunctive 'or of substantially all of the properties, * * *'."

This language was quoted by the General Counsel of the Bureau of Internal Revenue and the construction adopted by him in G. C. M. 8565, IX-2 C. B. 127.

The General Counsel said in another ruling, promulgated in 1927 (G. C. M. 1753, VI-1 C. B. 138):

> "For example, a transfer of all the assets of a corporation constitutes a reorganization under the second part of definition (A) irrespective of the element of 80 per cent control demanded by definition (B)."

This language was quoted and followed by the Board of Tax Appeals in *Green v. Commissioner*, 24 B. T. A. 719, at 725.

In defining the word "reorganization" the Treasury Department in its Regulations, the Commissioner of Internal Revenue, the General Counsel of the Bureau of Internal Revenue, and the Board of Tax Appeals have stated that a reorganization took place where one corporation acquired substantially all of the assets of another corporation, and this without regard to any element of control or percentage of stock. (Petitioner's Brief, pages 21-27) It is true that in some of the cases stock was received. It may have been common and not preferred; it may have been preferred and not common. There was no requirement as to any particular percentage. The test of reorganization was based entirely upon the acquisition of substantially all of the assets.

Whatever applicable requirement of continuity there may be in the statute must be found in subdivision (b)(3) and in subdivision (e). Those sections of the statute say "stock or securities". Again it must be noted that this is in the disjunctive, and not the conjunctive as the expression is used occasionally by Respondent in his brief. The fact that securities alone are sufficient completely negatives the idea of continuity of interest. Bonds, notes, or other indebtedness constitute the holder thereof a creditor, not a proprietor. The holder of such obligations is not in control

and his rights are to receive the amount of money promised to be paid when and as due, and in default thereof to pursue his legal rights, to realize on his collateral, if any, or to collect his debt if he can.

What then is this continuity of interest? Under the statute it may be either stock or securities. As pointed out, no particular percentage of either is required. It is something shadowy and ephemeral. Construed as counsel for Respondent suggest, that the idea of continuity of interest is a limitation upon the definition of "reorganization", and without any idea as to how much stock or how much in amount of securities is necessary for that continuity of interest, the statute is impossible of construction. The percentage of stock or securities of the total proceeds received by the transferor may be great or small, and the percentage of the stock or securities of the total outstanding of the transferee corporation may be infinitesimal. Would one share of stock out of General Motors' 40,000,000 shares be "continuity of interest"? Would one debenture or bond or other promise to pay of small denomination be "continuity of interest"?

We believe that properly construed, the statute provides for all such contingencies, is perfectly definite and has no such anomalous or grotesque results. As suggested above, the various subdivisions of section 203 completely provide for the taxable effect, gain or loss as the case may be, in every case. For example: exchange of property for property, no gain or loss; exchange of stock or securities for stock or securities, no gain or loss; exchange of property solely for stock or securities, no gain or loss; exchange of property for stock or securities and money, if retained by the transferor, a taxable gain not to exceed the money; transfer of property for stock or securities and money, and liquidated to stockholders, no tax to the corporation but only to the stockholders. It will thus be seen that whether the percentage of cash to stock or securities is large or

small, the statute adequately provides for its taxable effect. If the percentage of money received is small, there may be some taxable gain but not the full amount of the profit, leaving to the disposition of the stock or securities the final ascertainment of the gain. If the percentage of the money received be large, the full amount of the profit may be taxed either in the hands of the corporation, if not distributed, or in the hands of the stockholders, if distributed.

Stock or securities.

Respondent contends that the notes in this case, although secured by bonds in turn secured by a first mortgage on all of the properties of the transferee, including properties from another corporation, are not securities; that even though such notes may be securities in the general acceptation of the word they should not be so considered in this case. He suggests that the statute does not mean purchase money obligations. It would seem that where the statute is discussing the transfer of assets for securities, purchase money obligations would be the thing primarily contemplated. He then suggests that the word "securities" should not apply to comparatively short-term obligations. A short-term note may or may not be the equivalent of cash. On Respondent's own theory of a postponement or deferment of tax until the securities are realized upon, the sooner the notes are paid the sooner profit is subject to tax. It is true that the Board of Tax Appeals said that the notes in this case were not securities within the meaning of this statute, but that conclusion was reached entirely because the Board held there was a difference between an exchange and a sale.

Plan of reorganization.

Counsel in his brief, page 20, states:

> "The record contains no express finding that the transfer of Petitioner's assets in this case was pursuant to any 'plan of reorganization'."

In answer to this, it is only necessary to quote the following language from the findings of fact made by the Board of Tax Appeals:

> **"The transfer of the assets of petitioner to the Florida West Coast Ice Company in exchange for cash and notes, the distribution in liquidation of the proceeds thereof to the stockholders of petitioner and the dissolution of petitioner were made in accordance with and pursuant to a *plan* of the officers and stockholders of petitioner, which *plan* was formulated prior to the execution of the agreements of November 4, 1926, between Citizens Ice & Cold Storage Company and National Public Service Corporation." (R. 19) (our italics)**

Counsel said that the "plan" was the transferee's plan. The transfer of substantially all of the property of petitioner and of Citizens Ice & Cold Storage Company for cash and notes of a new corporation to be formed and the liquidation and dissolution of the two transferor corporations was the "plan" of petitioner and Citizens Ice Company.

PARTY TO REORGANIZATION.

It is further stated that petitioner was not a party to the reorganization. We repeat petitioner was not only a party but a necessary party to the transaction which in fact took place. Counsel refers to subdivision (h)(2) of section 203 which states:

> "The term 'a party to a reorganization' includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation."

Section 2(b) of the Revenue Act of 1926 states:

> **"The terms 'includes' and 'including' when used in a definition contained in this Act shall not be deemed to exclude other things otherwise within the meaning of the term defined."**

The words "include" and "including" in this section have properly been defined as words of enlargement rather than restriction. Paragraph (h)(2) above quoted was necessary in order to include the particular parties therein described. The section means that in addition to all persons who were in fact parties, there shall be included the persons described in that paragraph.

THE AMOUNT PAID TO CREDITORS.

Counsel makes much of the fact that the $400,000.00 cash provided for in the contract was paid to creditors instead of to stockholders.

This point is discussed in Petitioner's Brief, pages 39-41. The substance of the transaction was a transfer of substantially all of Petitioner's assets, free of indebtedness and liens, for secured notes of another corporation. Obviously, only the net proceeds of a transfer may be distributed to stockholders. Counsel, however, state, "so much of the profit from the sale as is used in the payment of debts will never be taxed unless it is taxed to the corporation for it never reaches the stockholders and it is not taxable as such to the creditors." This statement is clearly inaccurate. The statute imposes only one tax and that on the stockholders and the amount of each stockholder's profit is determined by comparing his cost with his realization. The fact that part of the corporation's consideration was used to pay its indebtedness makes no difference in the amount of the stockholders' profit. The debts must be paid in order to determine the amount distributable to the stockholders, otherwise the stockholders would receive a distri-

bution subject to the liabilities. If the gross proceeds of the transfer were distributed to the stockholders subject to the liability to pay the current debts, the result would be exactly the same and counsel would have no basis for the point.

In stating that the money paid to creditors would escape taxation counsel assume that the corporation is taxable, which is the question before the court. Even so, upon what theory is it assumed that money paid to the creditors is the profit. Normally the contrary would be the fact. The creditors must be paid and the balance, if any, must be looked to for the profit. Of course, assuming that the corporation were subject to tax, in determining its profit the amount paid to its creditors is and was taken into consideration in ascertaining the proceeds of the transfer.

Respectfully submitted,

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